No. 17-494

In The

Supreme Court of the United States

SOUTH DAKOTA,

Petitioner,

v.

WAYFAIR, INC., OVERSTOCK.COM, INC., AND NEWEGG, INC.,

Respondents.

On Writ Of Certiorari To The Supreme Court Of South Dakota

BRIEF FOR DAVID A. FRUCHTMAN AS *AMICUS CURIAE* SUPPORTING NEITHER PARTY

DAVID A. FRUCHTMAN
RIMON P.C.
245 Park Avenue, 39th Floor
New York, NY 10167
(646) 681-2268
david.fruchtman@rimonlaw.com

March 5, 2018

COCKLE LEGAL BRIEFS (800) 225-6964
WWW.COCKLELEGALBRIEFS.COM

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INTEREST OF *AMICUS CURIAE*[1]

Amicus Curiae's interest in this case is attributable to his specialized tax practice, as described below.

Amicus is an attorney in private practice and is the chair of Rimon, P.C.'s State and Local (Subnational) Taxation practice. For the last 26 years, his practice has been devoted exclusively to state and local tax planning and controversy issues across the United States. In 2003, he was a Special Deputy Attorney General of the state of Hawaii regarding a specific tax issue. For some 24 years, he has been the co-author of the Illinois chapter of the American Bar Association's annual "Sales and Use Tax Deskbook," and he is a former chairman of the Income and Franchise Taxes Subcommittee of the American Bar Association's state tax committee. He is the author of many articles, has guest lectured at many universities and tax organizations and, for 13 years, lectured at New York University's Summer State and Local Tax Institute on topics including "Constitutional and Other Jurisdictional Constraints on State and Local Taxation."

Amicus is submitting this Brief out of a concern that, because the points raised in this Brief do not favor the result sought by either party, these important

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[1] Rule 37.6 statement: All parties received notice of *Amicus Curiae's* intent to file this Brief and consented. Further, no counsel for any party authored this Brief in whole or in part and no person or entity other than *Amicus* funded the preparation or submission of this Brief.

considerations will not otherwise be presented to this Court.

STATEMENT OF NONSUPPORT FOR EITHER PARTY

The question presented is "Should this Court abrogate *Quill*'s[2] sales tax only physical presence requirement?"

This Brief is filed pursuant to Supreme Court Rule 37.3(a) and takes no position as to whether this Court should respond "Yes" or "No" to the Question Presented. Rather, this Brief takes the position that *if* the Question Presented is answered "Yes," then the abrogation of *Quill*'s physical presence requirement should be limited to retail sales of tangible personal property. That is, in-state physical presence should continue to be required before a state may impose a sales tax collection responsibility on retailers of services.

Neither party is expected to assert or support the position set forth herein, hence the need for this Brief:

- Petitioner is a state that imposes sales tax on retail sales of all types of tangible personal property, with a few exceptions.[3] Petitioner also imposes sales tax on retail sales of all services, but specifically exempts a lengthy list of services from sales

[2] *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

[3] SDCL 10-45-2, et seq.

taxation.[4] Petitioner can remove any (or all) of those service exemptions at any time. As such, Petitioner has no interest in arguing that *Quill*'s physical presence requirement should be retained with respect to retail sales of services.

- Respondents are retailers of tangible personal property.[5] As such, Respondents' focus in this case is expected to relate exclusively to Petitioner's attempt to impose sales tax collection and remittance responsibilities on Respondents' sales of goods. Respondents have no interest in arguing that, if the Question Presented is answered "Yes," *Quill*'s physical presence

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[4] SDCL 10-45-1 and 10-45-12.1, et seq.

[5] *See* Wayfair, Inc. Form 10-K (Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Commission Act of 1934 for the Fiscal Year Ended Dec. 31, 2016), page 2 (describing itself as "one of the world's largest online destinations for the home . . . we have built one of the largest online selections of furniture, décor, decorative accents, housewares, seasonal décor, and other home goods."; Newegg Inc., which on its Newegg.com Internet site, Corporate Summary, Who We Are, describes itself as "a leading online retailer. . . . With more than 10.5 million products . . . " (accessed Feb. 13, 2018); and Overstock.com Form 10-K (Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Commission Act of 1934 for the Fiscal Year Ended Dec. 31, 2016), pages 6-7 (describing itself as "We are an online retailer and incubator of blockchain technology. . . . In our retail business, we deal primarily in price-competitive, new and replenishable merchandise and use the Internet to aggregate both supply and demand to create an efficient marketplace for selling these products" and at page 47 explaining that its blockchain technology activity is insignificant as compared to its retailing business.

requirement should be retained with respect to retail sales of services.

SUMMARY OF ARGUMENT

The reasoning and physical presence requirement of *National Bellas Hess, Inc. v. Department of Revenue of Ill.*, 386 U.S. 753 (1967) and *Quill* apply to all remote retailers,[6] including retailers of tangible personal property and retailers of services. Remote retailers in both sectors are potentially subject to sales tax collection and remittance requirements throughout the United States, which the Court in *National Bellas Hess* and *Quill* considered to be an unjustifiable local entanglement with the national economy.

Even if this Court determines that retailers of tangible personal property have outgrown the physical presence requirement, the Court should retain that requirement as applicable to sales of services. This is because, as contrasted with the well-developed principles controlling the taxation of sales of tangible personal property, the taxation of sales of services is in its early stages. The states do not yet know how to impose sales taxes on multistate services, as demonstrated by the fundamental questions that are as-yet unanswered and by three large states' quick repeal of their

[6] "Remote retailer" refers to a retailer that does not have physical presence in a particular state, either by itself or through any representative.

attempts to impose sales taxes on a broad base of services.

The importance of the retention of the physical presence requirement for services is underscored by the enormous amount of sales taxes potentially at issue when services are taxed, which the states are finding impossible to ignore. For example, California found that legislation proposed in 2014 to tax services would have generated $122 billion in sales taxes. While that bill did not become law, efforts to enact a California sales tax on services continue to this day. Moreover, in just over the last five years, there have been high-level proposals and published studies recommending the taxing of a broad base of services in New York, Pennsylvania, Illinois, Kentucky, Georgia, Vermont, Connecticut, and Indiana, as well as California.

It seems clear that the states have begun a period of actively attempting to tax retail sales of services, and of enforcing the collection of those taxes by service providers outside of the taxing state. This process will involve many trials and, unavoidably, many errors. To protect the nation's services sector from being unjustifiably entangled in this experimental process, this Court should retain *National Bellas Hess* and *Quill*'s physical presence requirement for the services sector.

ARGUMENT

A. *National Bellas Hess* and *Quill* Set Forth Long-Enduring and Still Valid Constitutional Principles Protecting All Remote Retailers From Unjustified Local Entanglement.

In *National Bellas Hess*, with Archibald Cox advocating for the remote retailer, this Court interpreted the Commerce Clause[7] to require some physical presence of a retailer in a state before that state can require the retailer to collect its use tax. The Court based its holding on the "welter" of tax compliance rules that would entangle interstate commerce if every state, municipality, and school district were empowered to require remote retailers to administer their taxes. *Id.* at 759-760. The Court concluded that "The very purpose of the Commerce Clause was to ensure a national economy free from such unjustifiable local entanglements." *Id.* at 760.

This Court and Professor Cox's reasoning provided a barrier between a growing national economy and thousands of tax-hungry jurisdictions. A quarter of a century later, in *Quill*, this Court reaffirmed the importance of that Commerce Clause barrier. The Court did so with reasoning building on *National Bellas Hess*:

> "the Commerce Clause, and its nexus requirement, are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy.

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[7] U.S. Const. art. I, § 8, cl. 3.

> Under the Articles of Confederation, State taxes and duties hindered and suppressed interstate commerce; the Framers intended the Commerce Clause as a cure for these structural ills. *See generally* The Federalist Nos. 7, 11 (A. Hamilton). It is in this light that we have interpreted the negative implication of the Commerce Clause. Accordingly, we have ruled that that Clause prohibits discrimination against interstate commerce, *see, e.g., Philadelphia v. New Jersey*, 437 U.S. 617 (1978), and bars state regulations that unduly burden interstate commerce, *see, e.g., Kassel v. Consolidated Freightways Corp. of Del.*, 450 U.S. 662 (1981)."

Quill at 312.

The *Quill* Court thereafter fully endorsed *National Bellas Hess*'s bright-line rule requiring retailers to have physical presence in a state before those retailers can be subjected to the burdens of the state's sales tax compliance system:

> "Such a [bright-line] rule firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes. This benefit is important, for as we have so frequently noted, our law in this area is something of a 'quagmire' and the 'application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their

> indispensable power of taxation.' *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457-458 (1959)."

Quill at 315-316. Furthermore, the Court credited the barriers and boundaries of *National Bellas Hess* and *Quill* with nothing less than the growth of an industry:

> Moreover, a bright-line rule in the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals. Indeed, it is not unlikely that the mail-order industry's dramatic growth over the last quarter-century is due in part to the bright-line exemption from state taxation created in *Bellas Hess*.

Quill at 316 (footnote omitted).

B. Retail Sales of Services Involve Considerations Different From Retail Sales of Tangible Personal Property.

In *National Bellas Hess*, this Court explained that the Commerce Clause protects the national economy from "unjustifiable local entanglements." *National Bellas Hess* at 760. The need for protection from unjustifiable entanglements applies to retail sales of services as much as it applies to retail sales of tangible personal property. However, the practicalities in the taxing of these sectors differ, such that the states are still in a "trial and error" phase in the sales taxation of services.

As is discussed below, states have had significant difficulties taxing services even when the services are performed and benefits are received in the same state. The complications when multiple states are involved include all of these and more. In this unstable environment, if the states can require remote service providers to collect and remit their sales taxes, the result will be an unjustifiable local entanglement of the national economy in a welter of local tax laws.[8]

1. The Services Sector Has Thrived in Part Due to an Absence of State Sales Taxes and Sales Tax Compliance Requirements on Service Providers.

This Court stated in *National Bellas Hess* that the Commerce Clause protects the national economy from *unjustifiable* local entanglements. *National Bellas Hess* at 760. The states are now highly experienced in sales and use taxation of retail sales of tangible personal property. Nonetheless, they are unable to reliably collect this longstanding and important source of tax revenue. Therefore, this Court might now conclude that remote retailers of tangible personal property have outgrown the physical presence requirement and that the states may enforce their tax collection requirements against such remote retailers. However, even if the Court reaches that conclusion regarding retailers

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[8] In one of the important trends in state taxation, the states are actively looking for opportunities to expand their sales taxes to cover a broad-base of services, including services performed in other states. Section B.3 below provides an analysis of this trend.

of tangible personal property, the Commerce Clause concerns and principles set out in *National Bellas Hess* and *Quill* remain valid and apply fully to remote service providers.

At the time of *National Bellas Hess*, the states made little effort to impose sales taxes on retail sales of services. Moreover, the states' focus on retailers of tangible personal property but not on retailers of services remained much the same over the next 25 years. So, while *National Bellas Hess* applies to the services sector no less than it applies to the rest of the national economy, there was little if any development in this area of the law.

State sales and use taxation was much the same 25 years later when this Court decided *Quill*: a focus on the taxation of retail sales of tangible personal property, including remote retailing of tangible personal property. Relatively little sales tax attention was paid to the taxation of retail sales of services.

Those extended periods of quiet for the national economy's services sector fostered the growth of that sector, as was found in a 2000 university study. That study concluded that the services sector was growing because it was relatively untouched by state and local sales taxes:

> "We believe that increased sales taxation [of tangible personal property] is a contributing factor to the growth of the service sector. Across states, after controlling for many other factors, the value of service receipts as a share

> of income is positively correlated with the sales tax rate [on tangible personal property], while the value of retail receipts is inversely correlated (see Table 5, columns (1) and (3)).”[9]

The study's conclusion is strikingly similar to this Court's observation in *Quill*, as is quoted above, that the mail-order industry's dramatic growth was due, in part, to not having to contend with a welter of subnational taxes and tax compliance obligations.

This Court should reject any claim that the states know how to impose sales tax collection obligations on remote retailers of services without unjustifiably harming the services sector of the national economy. The overwhelming evidence is to the contrary, namely:

- The growth in the services sector when it is not entangled with a mass of state and local tax compliance requirements. This gives the states a very high standard to meet to demonstrate a lack of harm to the services sector;
- The small reliance presently by states on tax receipts from sales taxation of services (intrastate and interstate) as, in general, states tax only those few services that are specifically identified; and

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[9] *“Did Distortionary Sales Taxation Contribute to the Growth of the Service Sector?”*, David Merriman and Mark Skidmore, National Tax Journal, Vol. LIII, pp. 125, 140 (March 2000) (referenced table omitted from this Brief).

- The great difficulties the states have encountered in their attempts to impose broad-based sales taxes on services, including remote services, as is discussed below. This belies any possible claim that the states can impose sales tax collection and remittance obligations on remote service providers without entangling them in local laws.

2. States Have Been Unsuccessful in Their Attempts to Fashion Sales Taxes Applicable to a Broad Base of Services.

The states' posture today regarding the sales taxation of tangible personal property and services is much the same as what it has been since the issuance of *National Bellas Hess*: Almost every state that imposes a sales tax does so on all retail sales of tangible personal property (each state has a few exceptions). States and vendors are very experienced with the taxation of these sales.

In contrast, most states do not impose sales and use taxes on retail sales of services unless those sales are expressly made taxable.[10] Thus, in almost all states only a few services are subject to sales taxation. Consequently, a very large portion of the nation's economy has no familiarity with sales tax laws, regulations, or

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[10] Only Hawaii, New Mexico and South Dakota impose sales taxes on a broad-base of services.

principles, and no familiarity with sales tax collection and remittance procedures.

Moreover, the states themselves have not yet resolved many thorny issues raised by taxing retail sales of services, including:

- basic considerations affecting the taxation of both intrastate and interstate sales of services, such as definitions (e.g., what are "legal services"? Do legal services include assistance with a real estate filing? Assistance obtaining a business license? Assistance obtaining a sales tax license? Assistance obtaining a marriage license? What about an unregulated service, such as interior design services – which activities come under the umbrella of that phrase? Which do not?);
- the avoidance of pyramiding of taxes.[11] This complication affects tax collection requirements for both intrastate and interstate sales of services;
- the sourcing and apportioning of sales.[12] This complication affects tax collection

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[11] "*Expanding Sales Taxation of Services: Options and Issues*," Michael Mazerov, Center on Budget and Policy Priorities, State Tax Today, 2009 STT 161-2 at pp. 51-52 (Aug. 24, 2009). *See also* "*State Sales Taxes on Services: Massachusetts as a Case Study*," Samuel B. Bruskin and Kathleen King Parker, Tax Lawyer, v. 45 at 49 (Section E) (Fall, 1991).

[12] "*Expanding Sales Taxation of Services*" at p. 53. *See also* "*State Sales Taxes on Services*" at Section D.

requirements of interstate sales of services only.

The pyramiding issue is important because it violates a fundamental principle of sales taxation that only end-consumers should be taxed. When tangible personal property is sold, determining who is the end-consumer of that tangible personal property is generally straightforward.

However, determining who is the end-consumer of services is more difficult. As a result, it is possible that purchasers of services will pay tax on those services, even though the service will be resold (and taxed again) or will be a component of another service (and taxed again). For example, hotels often offer a service of overnight dry cleaning. The hotel pays a drycleaner to do the work. The hotel then marks up the cost of the dry cleaning and charges the guest the higher amount. Here, no tax should be due on the hotel's purchase of the dry-cleaning service, with tax instead being charged on the guest's payment for the service. But whether that result can be achieved will depend on the contours of the state's resale exemption.

Pyramiding of sales taxation of services also creates artificial incentives for businesses to use their own employees to provide a service even if an outside business can perform the service more efficiently.[13] This inefficiency occurs because no sales tax is charged when an employee performs a service for his employer,

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[13] "*Expanding Sales Taxation*" at 53.

but sales tax is charged when that same employer engages a third-party to perform the service.

Likewise, sourcing and apportioning of sales of services presents a series of complications unparalleled in sales of tangible personal property. These include identifying the location of delivery of a service, identifying the locations where the benefits of the service are received, determining the percentage of the service used in a state, and more.

For example, states are increasingly requiring service providers to collect sales tax on the sale of cloud computing services. However, cloud computing services are not "delivered" in any state in the way that tangible personal property is delivered. Thus, in transactions involving Software as a Service ("SaaS"), the purchaser may be anywhere in the world when accessing the service provider's software. Furthermore, a purchaser might access the SaaS application from multiple states, either because the purchaser is traveling or because several employees in the purchaser's business are authorized to access the SaaS. Moreover, that software itself might be anywhere in the world, including in a location that is unknown to both the purchaser and the service provider.

The states have differing approaches to taxing cloud computing services, and those approaches are continuing to evolve. As such, it is difficult for a remote service provider of cloud computing services to know where it must collect sales taxes and how much tax it is supposed to collect. Left unchecked, the ability of

states to impose a variety of tax collection burdens across state lines will create an unjustifiable local entanglement with these providers, and with the services sector, generally.

Certainly, the states will continue to experiment with methods for taxing sales of services. Unavoidably, this process will involve fundamental missteps, as demonstrated by the unsuccessful attempts by three of the most populous states (Florida, Massachusetts, and Michigan) to impose broad-based sales taxes on the services sector. Each of those attempts was quickly repealed.

Florida's 5% tax on services went into effect in July 1987. From the start, taxpayers were confused regarding the reach and administration of the tax, and the tax met enormous opposition. This culminated in the repeal of the services tax less than six months after it became effective. After that repeal, one of architects of Florida's tax acknowledged the difficulty of imposing sales tax on services, writing that:

> "Once the tax became effective July 1, 1987, confusion over the scope of the tax and difficulties encountered by taxpayers who sought to comply with it added to the swell of public indignation. . . . Multistate businesses claimed that it was simply impossible to comply with the rules for apportioning the sales tax base, particularly when a purchase was made by

> one member of an affiliated group of corporations."[14]

Significantly, remote retailers are directly impacted by both of those items (confusion over the tax's scope and impossibility of apportioning the sales tax base).

Massachusetts and Michigan had even worse experiences when they attempted to impose sales taxes on the services sector. Massachusetts's attempt to tax services became effective on March 6, 1991 and was repealed *two days later*, on March 8, 1991, retroactive to March 6.[15] And, in 2007, Michigan's service tax did not last even one day.[16]

Of the 45 states that impose sales taxes, few have considered in any depth the issues raised by requiring retailers of interstate services to collect sales taxes. The New York State Department of Taxation and Finance ("Department") has addressed the issue in limited circumstances, and its experience is telling:

- In 2013, Department issued an advisory opinion informing a business as to how to collect New York City sales taxes on its sale of a credit rating services.[17] The

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[14] *"Florida's Sales Tax on Services,"* Walter Hellerstein, National Tax Journal, Vol. XLI, pp. 1, 15 (March 1988).

[15] *See "State Sales Taxes on Services," supra.*

[16] Michigan P.A. 93 of 2007 repealed by P.A. 145 of 2007.

[17] TSB-A-13(27)S (Sept. 9, 2013). (Following New York City's financial crises in the 1970s, responsibility for administration of its sales tax was shifted to the New York State Department of Taxation and Finance. NYC Administrative Code §§ 11-2001(d) and 11-2002(c).)

> business's customer was based in North Carolina, with offices within and without New York State. The advisory opinion instructed the taxpayer to collect New York City sales tax on the sale of the credit rating service if the customer's representative who signed the engagement letter with the taxpayer is in New York City when the taxpayer delivers its rating letter to that representative.
>
> Less than two years later, the Department changed its position. It now advised that credit rating services would be subject to New York City sales tax if the address to which the taxpayer's invoice is sent is in New York City.[18] This is an entirely different method for determining the location of the sale of the service and establishing tax collection responsibility.

There is nothing inherently wrong with either of those approaches to determining tax collection responsibility for sales of services. However, such changing of tax collection rules is a problem for the economy's services sector, especially considering that there are up to 45 states for which such compliance might be required, along with thousands of political subdivisions within those states. And not all rules for determining tax collection obligations will be as unobjectionable as New York's. Litigation regarding more aggressive state approaches is likely.

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[18] TSB-M-15(4)S (July 24, 2015).

The hazards for the national economy from this state experimentation are obvious. Indeed, this is very much the welter of tax compliance rules, and entanglement of interstate commerce, that concerned the Court in *National Bellas Hess*. Retaining the physical presence requirement of *National Bellas Hess* and *Quill* protects remote service providers from that entanglement while the states experiment with new approaches to taxing services.[19]

3. Notwithstanding the Above, Sales Taxation of the Services Sector Seems Inevitable Due to the Amount of Potential Tax Revenues.

Despite a history of limited or no sales taxation of services, and despite the difficulties and unanswered fundamental questions regarding sales taxation of services, it is virtually certain that the states will continue to attempt by trial and error to create an administrable method of imposing sales taxes on intrastate services.[20] The tax receipts potentially available are so great that no other outcome seems realistic.

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[19] The states undoubtedly will treat a corporation that is both a retailer of goods and a retailer of services as having company-wide tax presence if any line of its business has tax presence in a state. This treatment may be justified under *National Geographic Society v. California Bd. of Equalization*, 430 U.S. 551 (1977).

[20] This Brief does not dispute the states' right to impose sales taxes on services, whether (i) wholly performed and wholly received within the one state, or (ii) performed in multiple states and received in multiple states. Rather, this Brief opposes any

Of course, taxing interstate services raises additional complications, which the states could choose to avoid by taxing intrastate services only. However, no state has yet indicated a desire to do this. Rather, every bill, budget proposal, and report discussed below proposes the sales taxation of services without regard to whether doing so crosses state lines.

California's very recent experience demonstrates why broad-based sales taxation of the services sector is highly likely, if not inevitable. On December 1, 2014, California Senate Bill 8 was introduced with the purpose of imposing sales tax on all retail sales of services. The California State Board of Equalization estimated that the new tax would generate $122 billion in new tax revenue for the state and its sub-state units of government during fiscal 2016.[21] To put that figure in perspective, consider that the U.S. Census Bureau reports that during fiscal 2014 all states collected $866 billion from all taxes.[22] Allowing for uncertainty as to whether the Census Bureau treated California municipalities

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state being permitted to impose sales tax collection responsibility on service providers lacking the in-state physical presence required by the Commerce Clause as interpreted by *National Bellas Hess* and *Quill*.

[21] *"Estimate of Potential Revenue to be Derived From Taxation of Currently Non-Taxable Services,"* California State Board of Equalization (April 14, 2015).

[22] *"State Government Tax Collections Summary Report: 2014,"* U.S. Census Bureau (Released April 16, 2015) (available at https://www.census.gov/content/dam/Census/library/publications/2015/econ/g14-stc.pdf) (accessed on Feb. 23, 2018).

as fiscal bodies independent of the state,[23] California's new tax on services would have generated 7% to 14.1% *of the total amount of all taxes collected by all states during 2014*. Or, considering only sales taxes, California's new tax on services would be 14.8% to 29.6% *of the total amount of sales taxes collected by all states during 2014*. This is in addition to the sales taxes California already collects on the retail sale of tangible personal property.

Although that 2014 California Senate Bill did not become law, efforts to enact a California sales tax on services continue to this day. *See, e.g.*, *"California Lawmaker Says Taxing 'High-End' Services Could Blunt Tax Reform Blow,"* Paul Jones, State Tax Today, 2018 STT 2-2 (Jan. 3, 2018).

In just over the last five years, expansions of the types of services subject to sales tax have been proposed in states literally coast-to-coast. Governors, legislators, university studies, "Blue Ribbon" studies, and tax organizations in New York,[24]

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[23] The Census Bureau report cautions that "The state government tax data presented by the U.S. Census Bureau may differ from data published by state governments because the Census Bureau may be using a different definition of which organizations are covered under the term, 'state government'." *See "2014 State Government Tax Collections Methodology,"* U.S. Census Bureau (Released April 16, 2015) (available at http://www.census.gov/govs/statetax/population_of_interest.html) (accessed on Feb. 23, 2018).

[24] *"New York Tax Reform Commission Presents Final Report,"* Tax Reform and Fairness Commission (Released Nov. 14, 2013) State Tax Today, 2013 STT 221-44 (Nov. 15, 2013) describing, at p. 14, one of its conclusions as "Add additional services to the

Pennsylvania,[25] Illinois,[26] Kentucky,[27] Georgia,[28] Vermont,[29]

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sales tax base to create greater uniformity between the State and local tax bases."

[25] Governor Tom Wolf's 2015-2016 budget proposal included a recommendation to expand the Commonwealth's sales tax to include many services not then taxable. These included accounting services, investment advisory services, consulting services, advertising services, architectural services, legal services, graphic design services, computer programming services, computer design services and dozens of other services. *"Memorandum: Governor Wolf's Sales Tax Proposal,"* Pennsylvania Department of Revenue (March 18, 2015).

[26] *"Issue Brief: Expanding the Base of Illinois' Sales Tax to Consumer Services Will Both Modernize State Tax Policy and Help Stabilize Revenue,"* The Center for Tax and Budget Accountability and the Taxpayers' Federation of Illinois, State Tax Today, 2015 STT 97-12 (May 20, 2015).

[27] *"Kentucky Blue Ribbon Commission on Tax Reform Issues Recommendations,"* Governor Steve Beshear's Communications Office, State Tax Today, 2012 STT 244-16 (Dec. 17, 2012).

[28] *"Georgia State University Releases Report on State's Eroding Tax Base,"* State Tax Today, 2015 STT 197-21 providing a link to *"Georgia's Incredible Shrinking Sales Tax Base,"* Robert D. Bushman, Fiscal Research Center, Georgia State University, *see* p. 15 (Oct. 6, 2015) ("The shifts in household consumption toward services and online sales, for example, are likely permanent, but both can also be added to the sales tax base through legislation.").

[29] "Lawmakers Consider Sales Tax on Several Consumer Services," State Tax Notes, Neil Downing, 79 STN 263 (Jan. 25, 2016) which contains a link to a January 15, 2016 study commissioned by the Vermont legislature on the imposition of sales tax on services (*"Economic and Revenue Impacts of Sales Taxation on Selected Services, Per H489,"* from Tom Kavet, Nic Rockler and Jeff Carr, State Economist for the Administration to Steve Klein, Chief Fiscal Officer (Vermont) Joint Fiscal Office (Jan. 15, 2016). On page two, the study describes one of its conclusions as follows:

Connecticut,[30] Indiana,[31] and, as stated, California have all proposed such an expansion.

"No matter what, the cross-border effects are negative to the economy, but likely to be relatively small for the five taxes [sic: sample taxed services] considered – and probably smaller than for goods in general."

[30] "*Sale Taxation in Connecticut: For Presentation Before the Connecticut Tax Study Panel*," William F. Fox, Tax Analysts Doc. 2015-23784 (Oct. 27, 2015) at p. 20 ("Policy Option 4: Broaden the sales tax to more services used by consumers, including residential utilities and repairs to residential real property.").

[31] "*Mikesell Report Says Sales Tax on Services Would Be Feasible in Indiana*," Brian Bardwell, State Tax Today, 2015 STT 69-4 (April 10, 2015) reporting on the study "*Considering Sales Taxation of Services in Indiana: A Report Prepared for the Indiana Fiscal Policy Institute*," John Mikesell, Indiana School of Public and Environmental Affairs, State Tax Today, 2015 STT 55-17 (report dated March 18, 2015). The Report's Executive Summary includes the following conclusion:

> Adding services to the tax base would require considerable attention to insuring [sic: ensuring] that the tax not apply to services purchases made as business inputs. This problem would be particularly acute for services that may be purchased by either households or businesses (dual-use services).

The Report also identifies the following three "administrative concerns":

> (i) Services could be taxed either by redefining the tax to apply to sales both of tangible personal property and services, except those specifically exempt, or by selectively adding certain services to the short list now already taxed. Neither approach is without problems, as experience in Florida, Michigan, and Massachusetts illustrates. The experience does show the problems associated with trying to include services predominantly purchased by businesses in the expanded base.

The states are entering a process of actively attempting to tax retail sales of services, and to enforce collection of those taxes by service providers outside of the taxing state.

C. Any Rollback of the Physical Presence Requirement Should be Confined to Retailers of Tangible Personal Property.

The elimination of physical presence as a prerequisite to the imposition of tax collection responsibilities, combined with the states' interest in imposing sales taxes on the services sector, risks material, adverse effects on the national economy. This Court can avoid that hazard by limiting any rollback of the physical presence requirement to retail sales of tangible personal property.

The states do not now have a mature approach to requiring the collection of sales taxes on interstate sales of services, and it is unknown how long it will take for them to arrive at that point. The only

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(ii) Small business retailers may have compliance problems. Making the expanded tax as simple to comply with as possible matters for all businesses, especially small entities.

(iii) Many vendors who would face obligations to collect and remit sales tax on services already are in the state retail sales tax system because they sell taxable tangible personal property. Much of the new tax base undoubtedly is with these existing registered vendors. Special attention, however, would be warranted to assist the transition of new vendors into the sales tax system.

certainties are that there will be many trials and errors, and that this will be a contentious process. Therefore, until the states develop an efficient methodology for taxing interstate sales of services, this Court should continue to apply the physical presence requirement to service providers.

D. State Revenue Departments and Tax Practitioners Know How to Distinguish Sales of Services From Sales of Tangible Personal Property.

Imposing tax collection responsibilities on remote retailers of tangible personal property, while not imposing that responsibility on remote retailers of services, requires distinguishing between such retailers based upon what is being sold. Fortunately, that is not the additional burden that it might seem, as for decades this analysis has been a regular practice among state revenue departments and tax practitioners.

The analysis is known as the "true object" test (sometimes also called the "essence of the transaction" test or "dominant purpose" test).[32] Whatever the name,

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[32] *See, e.g.*, California Code Regs. 1501 ("The basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true objects of the contract; that is, is the real object sought by the buyer the service per se or the property produced by the service. If the true object of the contract is the service per se, the transaction is not subject to tax even though some tangible personal property is transferred.").

the concept is essentially the same: One evaluates whether the purchaser wanted to acquire tangible personal property or a service. For example, the retail sale of prepaid telephone cards has been held to be a nontaxable sale of a service, as the "true object" in purchasing a calling card is the long-distance service. The card serves only as a medium for securing the telephone service.[33]

Most important, for purposes of the position set forth in this Brief, is that the work of distinguishing sales of goods from sales of services is already being done.

CONCLUSION

Any abrogation of the Commerce Clause's physical presence requirement, as described in *National Bellas Hess* and *Quill*, should be limited to retailers of tangible personal property. The physical presence requirement should continue to apply to sales of services.

Respectfully submitted,

DAVID A. FRUCHTMAN
RIMON, P.C.
245 Park Avenue, 39th Floor
New York, NY 10167
(646) 681-2268
david.fruchtman@rimonlaw.com

[33] *See, e.g.*, Virginia Dept. of Tax., P.D. 94-325 (Oct. 24, 1994).